facts for Consumers

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Second Mortgage Financing

fast facts

- Second mortgages are different from first mortgages. They often carry a higher interest rate and are usually for a shorter period of time.
- Traditionally, second mortgage loans are offered with a fixed amount and a predetermined repayment schedule.
- Shop around and make comparisons when you are looking for a lender.
- Ask local banks, savings and loans, credit unions, or finance companies about their loan terms.
- Be sure to understand how much your monthly payments will be and what they include.

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If you are like most homeowners, you probably have a first mortgage loan on your home. Typically, such loans are for 25 to 30 years, with the monthly payments adjusted so that the loan is paid in full at the end of the term.

As you make monthly mortgage payments and the value of the home increases, your interest in the property (called "equity") grows. After a while, some homeowners may wish to borrow against the equity in their home to get cash, to make home improvements, to educate their children, or to consolidate personal debts. Because such loans are in addition to the first mortgage on the home, they are commonly called "second mortgage" loans.

Second mortgage loans are different from first mortgages in several ways. They often carry a higher interest rate, and they usually are for a shorter time, 15 years or less. In addition, they may require a large single payment at the end of the term, commonly known as a balloon payment.

Traditionally, second mortgage loans are offered with a fixed loan amount and a predetermined repayment schedule. Some lenders now offer lines of credit that allow you to obtain cash advances with a credit card or to write checks up to a certain credit limit. These often are called "home equity lines" because the equity in your

home is collateral for the amount of credit you request. As you pay off the outstanding balance, you can reuse the line of credit during the loan period.

This brochure provides answers to some common questions people ask when they begin shopping for a second mortgage or home equity loan. It discusses choosing a lender, the meaning of some mortgage terms, costs, disclosure documents, and contacts for resolving problems.

How do I Choose a Lender?

When you are looking for a lender, shop around and make comparisons. Interest rates, repayment terms, and origination fees may vary substantially. Ask your local banks, savings and loans, credit unions, or finance companies about their loan terms. Although you will want to select the lender who offers you terms most suited to your needs, be sure to ask and compare the annual percentage rates (APR) because they will give you the total cost of the loan, including financing charges.

If you have not done business with the lender before, or if the lender is unfamiliar to you, you may wish to ask your local Better Business Bureau or consumer protection office if they have any complaints against the lender.

How Long Will I Have to Repay the Loan?

Some second mortgage loans may extend for as long as 15 or 20 years; others may require repayment in one year. You will need to discuss the repayment terms with the lenders and select one who offers terms that best suit your needs. For example, if you need to borrow $20,000 to make repairs on your home, you may not want a loan that requires you to repay the entire amount in one or two years because the monthly payments may be too high.

Will My Interest Rate Change?

If you have a fixed-rate loan, the interest rate is set for the life of the loan. However, many lenders offer variable rate mortgages, also known as adjustable rate mortgages or ARMs. These provide for periodic interest-rate adjustments. If your loan contract allows the lender to adjust or change the interest rate, be sure you understand when the lender has the right to change the interest rate, whether there are any limits on how much the interest or payments can change, and how often the lender can change the rate. You also should know what basis the lender will use to determine a new rate of interest.

How Much Will My Monthly Payments Be and Will They Pay Off the Loan?

Be sure you understand how much your monthly payments will be and what they cover. Your lender should be able to give you this information in advance. With some loans, you will be required to make monthly payments on the principal and interest. With other loans, you may be required to pay interest only on the borrowed amount; in these loans, your monthly payments will not reduce the principal amount of the loan. With such a loan, you will be required to pay back the entire borrowed amount at the end of the loan period. These loans are popularly known as “balloon loans.” If your loan has a balloon payment, you should consider how you will arrange to repay the entire amount when it becomes due.

On “home equity lines,” the lender does not have to give you the exact amount of the monthly payment, but must explain how it is figured. This is because the borrowed amount will vary and your outstanding balance will change if you use the line of credit. However, if your monthly payment term is 5% of the outstanding balance and your outstanding balance is $5,000, your minimum monthly payments would be $250.

Will I Have to Pay Any Fees to Get This Loan?

Many companies will charge a fee for lending you money. The fee is usually a percentage of the loan and is sometimes referred to as “points.” One point is equal to one percent of the amount you borrow. For example, if you were to borrow $10,000 with a fee of eight points, you would pay $800 in “points.” The number of points lenders charge varies, so it may be worthwhile to shop around. If the fee seems too high, you may be able to bargain for or find a lower fee. Be sure to get the amount of the fee in writing before you take the loan. Many states limit the amount of fees a lender may charge on a second mortgage loan. You may want to check with your state’s consumer protection office or banking commissioner to determine whether there is a limit in your state.

What Should I Get in Writing?

If your loan is primarily for personal, family, or household purposes, the lender is required to give you a federal Truth in Lending disclosure form before you sign the customary loan documents, such as a note or deed of trust. This Truth in Lending form will tell you the actual cost of the loan. It includes the annual percentage rate, the finance charge, and the fees included in the loan. For “home equity lines,” your lender also is required to send you a periodic statement, usually monthly.

The lender also is required to give you a notice of your right of rescission. The right of rescission gives you three business days after signing for the loan and receiving the Truth in Lending Act disclosures to reconsider whether you want to take the loan. For additional information about the right of rescission, ask for the free FTC brochure, *Getting a Loan: Your Home as Security,* at the address listed at the end of this brochure.

If your lender makes any promises, such as saying you can "automatically" get the loan refinanced at the end of the term, be sure your lender puts these promises in writing. In this way, you may avoid any future disputes.

What Should I Do if I Have a Problem?

If you ever have a problem making your loan payments, talk to your lender as soon as possible. Some lenders will work with you to arrange a temporary payment plan. Also, call the lender if you have any questions about your loan.

However, if you have problems with your lender, you may want to contact your state, county, or local consumer protection office. If they cannot help you, they can refer you to the office that can.

The Federal Trade Commission is responsible for enforcing laws such as the Truth in Lending Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, and the Fair Debt Collection Practices Act. It also provides free brochures explaining these laws. For these or credit-related publications, write to: Consumer Response Center, Federal Trade Commission, Washington, D.C. 20580.

If you believe your lender may be violating a law that the FTC administers, you can contact the Consumer Response Center by phone, toll-free at 1-877-FTC-HELP (382-4357); TDD: 202-326-2502; by mail: Consumer Response Center, Federal Trade Commission, Washington, DC 20580; or by e-mail: use the complaint form at **www.ftc.gov**. Although the FTC cannot resolve individual consumer disputes, it can take action if there is evidence of a pattern of deceptive or unfair practices.